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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1951.

CENTURY ELECTRIC CO.,
Petitioner,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 548

PETITION FOR WRIT OF CERTIORARI
and
BRIEF IN SUPPORT.

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No. .....

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals for the Eighth Circuit.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Century Electric Co., a corporation organized and existing under and by virtue of the laws of the State of Missouri, having its office and principal place of business in the City of St. Louis, Missouri, respectfully prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit in cause styled "Century Electric Co., Petitioner, v. Commissioner of Internal Revenue, Respondent," affirming the decision of the Tax Court of the United States.

JUDGMENT AND APPLICATION FOR CERTIORARI.

The judgment of the United States Court of Appeals was entered on October 31, 1951, and this petition is filed within 90 days thereafter (Record p. 220).

STATEMENT OF THE CASE.

This case arises under the Interna' Revenue Code, and involves liability for income and excess profits taxes for the year 1943 (Record pp. 173-174).

Petitioner on December 1, 1943, conveyed certain improved real estate, hereinafter called the "foundry property," having an adjusted cost basis on that date of $531,710.97, to William Jewell College, a corporation, by warranty deed for a consideration stated in the deed and paid of $150,000. Immediately thereafter the trustees of William Jewell College, acting on behalf of said College, and petitioner executed an indenture of lease of the property to petitioner for a term of not less than 25 years nor more than 95 years. The tenancy of petitioner under said indenture of lease commenced on December 1, 1943 and was to continue for 95 years, or until its earlier termination pursuant to the terms of said indenture at the end of 25, 35, 45, 55, 65, 75, or 85 years. Certain rents were provided to be paid by petitioner to said William Jewell College throughout the term of said lease. The foundry property was necessary in the operation of petitioner's business both before and after December 1, 1943 (Record pp. 176-179).

Upon these facts, as more fully disclosed in the Record, two questions were presented to the Tax Court of the United States:

1. Whether or not loss should be recognized to petitioner in the amount of the difference between the said adjusted cost basis of the foundry property and the consideration received therefor, $150,000, and deductible from income in computing net income subject to normal tax, surtax and excess profits tax, and

2. Whether or not petitioner may, after acquiring said lease, deduct from income (as aforesaid) depreciation of that part of the amount determined to be petitioner's cost

of said lease which is allocable to said buildings and improvements upon and constituting part of said foundry property, based upon the remaining useful life of said buildings and improvements (Record pp. 173-174).

The Tax Court of the United States denied the deductibility of loss as aforesaid and computed depreciation upon the basis of 95 years, the maximum term of said lease, notwithstanding that said term exceeded the remaining useful life of said buildings and improvements (Record pp. 173 ff.).

On appeal, the United States Court of Appeals for the Eighth Circuit, in opinion entered October 31, 1951, affirmed the decision of the Tax Court (Record p. 220).

JURISDICTION TO REVIEW.

The jurisdiction of this Court is invoked under Section 1254 of the Judicial Code (Act of June 25, 1948, Chapter 646, 62 Stat. 928, 28 U. S. C. A. 1254).

STATUTES INVOLVED.

The following Federal statutes are involved:

"Section 23. **Deductions From Gross Income.**

"In computing net income there shall be allowed as deductions:

* * * * * * * *

"(1) Depreciation.—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income."

"Section 112. **Recognition of Gain or Loss.**

"(a) General Rule.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

"(b) Exchanges Solely in Kind.—

(1) Property Held for Productive Use or Investment.—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

* * * * * * *

"(e) Loss From Exchanges Not Solely in Kind.—If an exchange would be within the provisions of subsection (b) (1) to (5), inclusive, or (10), or within the provisions of subsection (1), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized."

DECISION OF LOWER COURT.

The opinion of the Court of Appeals is reported in 192 F. (2d) 155, and is printed on pages 211-220 of the Record. The Court of Appeals decided that petitioner "exchanged" the said foundry property for $150,000 in cash and a leasehold estate subject to the liability to pay rent as set out

in said indenture of lease and denied the deduction of loss. It held that petitioner's only capital investment after the transaction hereinabove described was in the leasehold and that it had no investment in the foundry properties, and that depreciation was to be computed over the maximum life of the lease rather than over the useful life of the value of the properties.

QUESTIONS PRESENTED.

The questions presented in this case are:

1. Whether or not loss is recognized under Section 112 of the Internal Revenue Code upon the sale of property when, immediately after the sale and pursuant to plan of which the sale was a part, the property is leased back by the seller.

2. Whether a lessee of improved real estate may depreciate its cost of the improvements upon such real estate over the useful life of such improvements, when such useful life is less than the maximum term of its lease.

REASONS FOR ALLOWANCE OF THE WRIT.

(A) **The Court of Appeals has decided an important question of Federal law which has not been, but should be, settled by this Court.** The question of whether or not loss is recognized upon the "sale and lease-back" of property is an important question. It has been much discussed.

The question has been decided by the Tax Court of the United States in *May Department Stores Company*, 16 T. C. 547, promulgated March 1, 1951; *Standard Envelope Mfg. Co.*, 15 T. C. 41, and *Brost Motors, Inc.*, 7 T. C. M. 806 (1948) [CCH Dec. 16,679 (M)]. In *May Department Stores Company*, supra, respondent has acquiesced and omitted to appeal the decision of the Tax Court of the

United States, which if it had been affirmed by a United States Court of Appeals, would have created a conflict with the decision in this case. Respondent thereby attempts, by preventing such a conflict, to defeat the jurisdiction of this Court in an important matter and preserve as the sole decision of an appellate court the decision favorable to his contention in this case, notwithstanding that the Tax Court has decided, and is deciding, cases to the contrary, basing its decisions upon an unsubstantial and formalistic distinction: whether a lease was for a period of more than 30 years, although terminable in less, or, on the contrary, a lease was for less than 30 years, although renewable for more. The distinction thus made is in conflict with the applicable decisions of this Court. (Taxation is a matter of substance—*Helvering v. Hallock*, 309 U. S. 106.) Further, the term of a lease received upon disposition of property is irrelevant to the distinction between a sale and an exchange.

(B) **The Court of Appeals has decided a Federal question in a way in conflict with the applicable decision of this Court,** to-wit, *Duffy v. Central Railroad Company of New Jersey*, 268 U. S. 55, which holds that a lessee is entitled to depreciation on improvements made by it and which will be consumed within a fraction of the term of the lease, such depreciation to be based upon the useful life of the improvements and not upon the term of the lease; and also *Helvering v. F. & R. Lazarus & Co.*, 308 U. S. 252, which holds that one who has sold property and leased it back is entitled to depreciate the property over its useful life. The rule so announced by this Court is considered established by the texts (*Mertens, The Law of Federal Income Taxation*, Chicago, 1942, Section 23.92; Vol. 4, pp. 109-110). The leases considered by those authorities, as the lease in this case, of course included both land and improvements, and the Court in this case points no distinction.

PRAYER FOR RELIEF.

Wherefore, your petitioner respectfully prays that a Writ of Certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Court of Appeals for the Eighth Circuit, commanding that Court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. 14,341, *Century Electric Co., Petitioner, v. Commissioner of Internal Revenue, Respondent,* and that the said judgment of the United States Court of Appeals may be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

CENTURY ELECTRIC CO.,

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BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

OPINION OF COURT BELOW.

The opinion of the Court of Appeals is reported in 192 F. (2d) 155.

II.

PRELIMINARY STATEMENT.

The summary statements of the matter involved, statement as to jurisdiction and statement of questions presented appear in the foregoing petition for certiorari and are adopted without repetition. Similarly, the statutes involved are therein set out and the errors specified.

III.

ARGUMENT.

1. Certiorari ought to be granted in this case because an important question is presented.

The question is presented in this case whether or not on the "sale and leaseback" of property loss is recognized under Section 112 of the Internal Revenue Code. The question of the computation of depreciation on property so sold and leased back is also presented. Thus this case presents the important aspects of "sale and leaseback." A determination of the tax consequences of such transactions is of importance in the day to day business in the United States as

well as in the collection and enforcement of the revenues of the United States.

That this is so is demonstrated by the very extensive discussion of the technique and its consequences in current law literature. Thus these and related questions have been considered in the following recent and current articles:

Illinois Law Review, Vol. 46, No. 1, p. 130;
Taxes, August, 1951, p. 662;
NYU Ninth Annual Institute on Federal Taxation, p. 959;
Taxes, September, 1951, pp. 759, 762;
NYU Eighth Annual Institute on Federal Taxation, p. 1133;
62 Harvard Law Review 1;
NYU Seventh Annual Institute on Federal Taxation, p. 599.

At the same time it is a matter of common knowledge and cannot have escaped the attention of this Court that the sale and leaseback technique is of increasing importance in the day to day transactions of business in the present economy. The instant case presents one example. As is disclosed by the record, Petitioner used this technique to increase its liquid working capital. In its material respects the transaction is typical of the numerous transactions which have been and are still occurring every day.

The transactions of others, of course, are not shown in the record, but their existence rests in common knowledge and reputation. It is known generally that Gimbel Bros., a large New York department store, has sold its improved real estate and now occupies the same under lease arrangements. It is a matter of common knowledge that Bullock's, a department store in Los Angeles, has also sold its property and occupies it now under lease. A large chain of grocery stores (Safeway Stores) no longer owns its loca-

tions, but leases them from its grantee. It is commonly reported (and shown in the offices of various Recorders of Deeds) that Sears, Roebuck & Co., desiring to have less of its capital tied up in real estate and more available for inventory, its primary source of profit, has sold some locations and is selling others with the contemplation of occupying them under long-term leases. This list cannot purport to be exhaustive.

Similarly, the techniques of landlord and tenant are being generally adapted to the financing of new construction. Thus insurance companies, in lieu of lending money, will purchase and improve real estate and lease it to the tenant for whom the improvement is particularly adapted for a long term with an agreement for the sale and purchase of the property at the end of the term or at some other time. In this manner the insurance company recovers its cost much as it would recover a loan of money. Compare *F. & R. Lazarus Co. v. Helvering,* 308 U. S. 252.

The New York Times, in its issues of December 13, 1948, December 14, 1948, and December 15, 1948, published a series of articles by Benjamin Fine illustrating the developing methods as used by educational institutions. The articles contain the following statements:

December 13, 1948:

> "Actually, the interest of colleges and universities in real estate or business investments reflects to a large extent the straitened financial circumstances of most educational institutions today.
>
> "The entire question of college finances is an extremely complicated one at present, the survey disclosed. Endowments of $2,500,000,000 are held by American colleges and universities. Of this amount, about $1,000,000,000, or forty percent, is invested in

real property, businesses or commodities. Before the war, less than twenty percent was invested, the rest being in government bonds or gilt-edge securities.

"Financial devices used by colleges and universities fall into these four broad categories:

"(1) **Acquisition of real estate, which then usually is leased to the original owners or operated by the institution itself.** (Emphasis ours.)

"(2) Ownership and operation of business.

"(3) Establishment by alumni and others of holding companies, organized to own and operate businesses, the income of which goes to the university.

"(4) Creation of research and patent holding corporations, the income going to support certain university activities.

"Land Buying Most Widespread.

"The Times study found that the first category is the most common practice among higher educational institutions today. The educators interviewed said the practice was 'growing like wildfire.'

"Almost all the major institutions are besieged by offers from business organizations to 'buy out' their buildings and then lease them back. Northwestern University, Evanston, Illinois, received 400 such offers in the last year.

"Another Midwestern institution said it had received at least 25 percent more offers of this nature than it did a year ago. The college officials said they turned down most of the offers, as they were anxious to acquire only properties that have long-term possibilities."

* * * * * * * *

"Union College, Schenectady, New York, through its subsidiary, Union Holding Corporation, has purchased the real estate of Allied Stores Corporation for $16,250,000. This corporation operates the country's largest department store chain. All the property was leased back to the original owners on long term basis.

"A year ago Union College acquired the real estate, store building and warehouse of Abraham & Straus, Brooklyn department store, for $9,000,000. All the real estate was leased back to the company on a 30-year basis with two 25-year renewals. Under the terms of the contract Union will get $14,000 a year for 11 years; $20,000 a year for the next 19 years; $50,000 a year for the first 25-year renewal period and $100,000 a year for the last 25 years stipulated in the lease."

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"Large scale purchases have been made by Oberlin College, Ohio. Dr. Vincent S. Hart, investment executive of the college, said the institution had bought such property as the Montgomery Ward Stores, a number of Woolworth buildings and Sears & Roebuck locations. The properties have been leased back to the businesses on 10 to 40 year leases to give the college a 'fair return' on its investment.

"The schedules generally call for the return of the investment in full within 25 years. The Oberlin properties are in many sections of the United States and some are in Canada. The college owns about $1,500,000 worth of property that has been leased back to the stores, Dr. Hart estimated. He added that the college would like to put more of its endowment funds into this type of investment.

" 'I'm dickering for one today,' he told this reporter. 'It should pay 4 percent. It is a sound propo-

sition. We feel that if we make these investments wisely, we can improve our profits.'

"'It is true that you can always run into a hazard. That is why we pick our investments so carefully. We look primarily to the credit of the organization, and not the value of the property we buy. If the concern cannot pay the money due on its lease, then of course we would get stuck. There might be some difficulty during a depression, but we pick and choose extremely carefully.'

"The college competes in the open market for valuable property. 'I just lost a $300,000 deal due to an insurance company,' Dr. Hart remarked.

"Similar projects also were among other institutions and following the same policies as Oberlin. The University of Pennsylvania, for example, purchased the building in which the Lit Brothers Department store is located in Philadelphia, and then leased the property back to the store. Dr. H. J. King, controller of the university, said in the neighborhood of $3,000,000 was paid for the building, although not all of it was in cash. The long term lease calls for an estimated annual rental of $275,000.

"Dr. King said his institution had turned down two other propositions recently, one involving a department store in Philadelphia, and the other a nation-wide system of chain stores. These offers, he explained, 'carried with them certain provisions that we were not willing to accept.'

* * * * * * *

"On the West Coast, the University of Redlands, in California, reports that it has about one-third of its total endowment of $1,115,000 invested in income prop-

erty. These consist of buildings occupied by chain stores, such as Woolworth's, Montgomery Ward, Lerner Brothers, Safeway Stores, other markets and gasoline stations."

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"From The Times study it is apparent that many institutions in all parts of the country are seeking greater income returns through real estate holdings, by acquiring businesses and by setting up alumni foundations to manage commercial concerns and corporations. Scores of others are seriously considering entering this field.

"This educational as well as financial development may have far-reaching implications."

December 14, 1948:

"Why do business concerns, most frequently retail stores, choose to sell their property to universities and then lease them back for their own use? An explanation for this unusual procedure is offered by Dr. R. J. Saulnier, Associate Professor of Economics at Barnard College. As director of the Financial Research Division of the National Bureau of Economic Research, Professor Saulnier has made an extensive study of the problems facing educational institutions. From the viewpoint of the corporation, he points out, the transaction has these advantages: 1. Since many concerns have mortgages on their real estate, selling the properties enables them to remove debt from the company's balance sheet, thus simplifying their capital structure.

"2. The cash proceeds of the sale, if not used entirely in debt reduction, improve the company's working capital position.

"3. The corporation gets out of the real estate owning business, a role it frequently does not enjoy.

"4. The sale places the corporation on an improved tax position. The corporation is permitted to deduct from its gross income, in computing its taxable net income, the full amount of the rent it pays to its new landlord (the university) as the property owner; on the other hand, a corporation may deduct only depreciation and interest paid on the mortgage."

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"Almost all college and university property purchases follow a standard pattern, according to Prof. Saulnier: the university finds a piece of property, generally a centrally located retail store occupied by one of the national chain organizations, and buys it outright. In some cases the university borrows the money, mortgaging the property as security, to finance the purchase.

"The next step is for the new owner to lease the property to the business concern for a term of 20 to 30 years, at a stipulated annual rental. An option for the tenant to extend the lease for additional terms generally is included in the contract. The amount of the rent is fixed so that it will yield the university an attractive rate of return on its investment for the first lease period, and return to the university all, or the major part, of its original investment."

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" 'This type of college activity has grown like wildfire,' one business officer said. 'There is nothing to stop an institution from organizing a charitable trust. There is nothing legaliy wrong in that. I'm sure that almost every institution in the country has had numer-

ous offers, asking the college to buy them out and then lease the buildings back to them again.' "

The same techniques are extensively used by other investors, particularly insurance companies. The character of the investor—whether a tax-exempt university, a taxable insurance company or a private person, makes no difference to the grantor-lessee.

William L. Cary has written on Sale and Lease-back of Corporate Property (*Harvard Business Review,* Vol. XXVII, No. 2, March, 1949, p. 151 ff.) as follows:

"Corporate financing through the sale and lease-back of property has been rather extravagantly described as 'the most noteworthy financial device of the present century.' Widely publicized in the financial periodicals, the sale and lease-back device is being currently hawked and brokered as a panacea for most corporate needs. It is said to be a source for more capital 'providing an almost inexhaustible supply of credit' and to result in improving, rather than harming, credit standing. It is referred to as an assured avenue for tax avoidance. From the investor's standpoint the lease-back arrangement is being offered as a top grade investment in which institutional buyers may participate.

* * * * * * * *

"As the name implies, a sale and lease-back arrangement commonly involves a sale of land and buildings to an investor by a business concern which simultaneously leases them back upon a long term contract, frequently making some provision for renewal or repurchase. The lease-back device is by no means a new discovery; there is an English case involving such an arrangement in 1882. Recently, however, the plan has

been much publicized because of a new element, the frequent participation of charitable and educational institutions in the financing transactions, although many of the sales are being consummated directly between the vendor corporation and insurance companies or, in some instances, private investors.

"Originally identified with retail stores having extensive real estate holdings, the device is spreading among other corporations which have a substantial proportion of assets tied up in buildings, warehouses, or other fixed plant. On the investing side the dominant role of mutual insurance companies which made their initial entry in the sale and lease-back field in 1945 is another noteworthy development. During 1947, for instance, insurance companies put approximately $125 million into this form of investment, bringing their total of such amounts at the year end to about $200 million.

"To show an illustration for subsequent discussion, a more or less typical example of a sale and lease-back might consist of the following: (1) A department store sells to an insurance company or a university all of its land and buildings, in many cases at cost or depreciated book value; (2) if the sale is not at book value there may be a loss which, depending on the date of the transaction, might be used as a carry-back to excess profits tax years; (3) simultaneously with the sale of the properties the department store obtains a lease upon them for a period often running from 20 to 30 years. The terms of the lease normally provide for annual rental payments which amount to a complete amortization of the purchase price plus a net return to the investor of 3½% to 4½% over the period of the lease.

* * * * * * *

"From the standpoint of life insurance companies and wealthy charitable institutions the sale and lease-back arrangement clearly offers another much needed medium of investment. It has been remarkably popular since 1945."

Mr. T. I. Parkinson, President of Equitable Life Assurance Association, has stated that:

"The more important new development in life insurance investment has been in the field of housing, both domestic and commercial * * *. In the field of housing for commercial purposes, recent legislation in New York and other states has made possible the present trend toward purchase by the life companies of income-producing property and its lease for long terms . . . This arrangement will, to an increasing degree, take the place of real estate mortgages on such property. Instead of business being owner of its premises and the life insurance companies mortgagee for a limited portion of the appraised value of the premises, the life insurance company will be the owner and the business will be the long term tenant at a net rental . . . " *Commercial and Financial Chronicle,* Vol. 165, page 1003, February 20, 1947.

The National Underwriter, an insurance trade journal, reported in December of 1948 as follows:

"New York. Some of the economic and legal problems with which counsel will be faced if the industry takes advantage of the purchase and lease of real estate were discussed at the annual meeting of Association of Life Insurance Counsel here by John W. McPherson, Assistant Counsel of Penn Mutual Life.

"The field is so new that as to taxes no cases have been found covering the construction of leases made

by life insurance companies under their legislative authority to invest in income real estate, he said. It is anticipated that the Treasury Department soon will take steps to fill this vacuum. It already has been alleged that the purchase-lease is a scheme based on tax evasion. Educational institutions have been attacked in congressional hearings for capitalizing on their tax exemption when investing in purchase-leases, and the Treasury Department has added a question to its form of information return made by certain tax exempt institutions regarding income from purchase-leases made by such institutions . . .

"Certain basic rules of income tax law explain why purchase-leases are attractive to only a limited group of investors . . . Although life insurance companies must report all rental payments as income for income tax purposes, the impact of corporate tax returns upon their rental income is less severe than in the case of the business corporations." *The National Underwriter* (Life Ed.), Vol. 52, page 3, December 10, 1948.

Business Week for May 28, 1949 (page 90) reported that:

"Life insurance assets are earning more money . . . credit for the bigger yield went mainly to a shift in the investment pattern. The companies were getting out of the low-yield Government bonds and into higher-yielding non-Government obligations . . . by the close of last year the companies were estimated to own about $383,000,000 worth of commercial rental properties—most were acquired since the war on purchase lease-back deals . . ."

There is recent evidence that the purchase and lease-back technique will in the future be an even more significant factor in the life insurance companies' and other's

investments. The *St. Louis Globe-Democrat* in the financial section of its issue on January 2, 1952, quoted McCune Gill, eminent authority on real estate, to that effect.

Beginning with Equitable Life Assurance Society's action announced March 27, 1950, life insurance companies have been using the purchase and lease-back technique in financing new railroad rolling stock—buying the cars from the manufacturer and receiving rentals from the railroads. Roger Carleson, writing in the *Commercial and Financial Chronicle* for March 30, 1950, reported that, in the two months following the announcement of Equitable's plan for this type of investment, contracts had been signed or negotiated for about 20,000 freight cars costing about $100,000,000.

The extensive use of this form of transaction by leading financial institutions demonstrates its importance and requires its consideration by this Court in order that businessmen may know their liabilities for taxes with particular reference to depreciation and gain and loss with sufficient certainty that they may continue their programs of expansion, new construction, and the like, which require additional capital.

The Court below has erred in any event. If the transaction be a loan, depreciation is unaffected. If it be a sale, loss is recognized. In calling it an "exchange" the court has merely used an inappropriate word, which does not make it an exchange, but merely results in the anomalous concept of an "exchange" of property for cash, making "sale" and "exchange" synonymous. However, the pertinent doctrines of law and the errors of the opinion of the Court below are better reserved for discussion on brief if this Court issues the writ herein prayed.

The instant case is typical. The record shows without contradiction that petitioner's commercial bankers ob-

jected to the low ratio of petitioner's current assets to its current liabilities (Record pp. 125, 132-133). This defect in petitioner's balance sheet position—important to the bankers—could be remedied in one of two ways: (1) By borrowing; but the loan would have to be for a long term, and few, if any, lenders are interested in lending money for 95 years. (2) By selling fixed assets, thus converting them to current assets. But petitioner required the use of its fixed assets in its business.

Hence, the bankers worked out a compromise technique, which they knew was being used. The property was sold, and possession retained under a lease. We think the petitioner sold the property; if we are in error, then the alternative is that petitioner borrowed money. There is no "third alternative."

The technique used is attractive now because of economic uncertainties, particularly with reference to the value of money; insurance companies, endowed institutions, churches, and similar persons, who have no pressing need of current cash, and who can invest for long terms, are satisfied to have real estate, though burdened (or benefited) with a long lease. Their real estate, in 95 or 100 years, is a thing of real value. But banks, and the usual lenders, cannot look so far ahead. The transaction offers the security of a loan; the investment of a purchase of real estate. It has aspects of both. While yielding current income, there is, to the investor, a principal value which is real and cannot be discharged by payment of a number of dollars fixed now for remote future payment.

Of course, petitioner considered what it believed to be the tax consequences of its transaction. With tax rates at 80% it would have been as improvident to omit this consideration as to omit consideration of wages, cost of materials, or any other item of expense from its planning.

The importance of the question is further demonstrated by the procedural methods which are chosen by the respondent in the cases involving the question. May Department Stores consummated an essentially similar transaction in Pittsburgh which was involved in the litigation reported under the name *May Department Stores Company* in 16 T. C. 547. The distinction between that case and the instant case is that in the instant case the lease under which petitioner occupied the premises was for a term of 95 years with privilege of cancellation at the end of 25 years and at other times. The lease in that case, however, was for a term of 25 years with privilege of renewal from time to time. The distinction seems purely formalistic, especially with reference to the question whether or not an exchange occurred. The Court below states that the question must be answered upon the substance and not upon the form of the transaction but its decision can be reconciled with other authority only upon the basis of form.

The Tax Court held in the *May Company* case that loss was recognized upon the sale. The Commissioner took no appeal. Thus, in substance, he abandoned the contention which he had made and is making in this case with reference to another taxpayer. Yet, inconsistently, he continues to press his assertions against this taxpayer, petitioner. While the *May Company* case does not furnish the basis of an allegation of a conflict of authority among the Circuit Courts, it does furnish the basis of a finding of a conflict of authority within the Commissioner's office and a conflict among courts, that is, between the Courts of Appeals for the Eighth Circuit and The Tax Court of the United States, which accomplishes the same injustices and uncertainties as the conflict among the Circuits would accomplish. The question is necessarily presented whether or not the respondent has abandoned his position in this case with reference to all other cases. This is an important question.

That so few cases are reported involving sale and lease-back, when the transaction has occurred so frequently, as reported in the public press, and the few cases reported are conflicting, demonstrates that the questions are unanswered and in confusion, and that either taxpayers are overpaying their taxes, in ignorance of the law, or respondent is foregoing the collection of revenues, in ignorance of the law, or that, inconsistently, in some cases the one and in some cases the other is occurring. The three possibilities are alike in that they are all unjust and wrongful.

2. Certiorari ought to be granted in this case because the decision of the Court below conflicts with the decision of this Court in Duffy v. Central Railroad Company of New Jersey, 268 U. S. 55, and Helvering v. F. & R. Lazarus & Co., 308 U. S. 252.

The Court below has held that after the sale and lease-back of petitioner's foundry property, loss of petitioner's investment in the property by wear and obsolescence is suffered ratably over the maximum possible term of the lease—95 years. The improvements obviously will be completely worn out in a far shorter time. There was evidence before The Tax Court to sustain the findings necessary [Petition, pars. 5 (a-2) and 5 (a-3) (Record p. 5, admitted in Answer, Record p. 19) Stipulation of Facts, pars. 2, 3 and 4 (Record pp. 23-24); Record p. 137; Record p. 138; Record p. 143]; nevertheless the Tax Court made no finding of the remaining useful life or cost of the improvements on the foundry property. When, because of the holding of the Court below that there was no sale of the property, these facts become material, it is necessary that they be found. In this case, the Court should either have found the facts from the record, for they are not in dispute, or remanded the case to The Tax Court for findings of fact.

Simply to deny the existence of facts is not reasonable nor just nor consistent with the decisions and practice of this Court. In *Commissioner v. Culbertson*, 337 U. S. 733, the case was remanded to The Tax Court for findings of fact. If the allocation of petitioner's cost between land and improvements on the leasehold estate is material, and not sufficiently disclosed in the record, this case should be remanded similarly.

The assertion that petitioner's investment is in the leasehold is fictional. To the same extent every lessee's investment is in his leasehold. It does not follow that wear, tear and obsolescence are also suffered over the term of the lease. In the typical case, where a lessee builds a factory on land leased for 99 years, the factory having a useful life of 33 years, the result of the Circuit Court's ruling would be that the lessee would be allowed deduction for depreciation long after the factory had crumbled to dust. The loss is suffered while the factory is used and the deduction should be taken when it is suffered. This is economic reality, perfectly consistent with the abstract law that a lessee holds a leasehold estate. The land and buildings deteriorate and proceed to their end at different rates; hence different rates of depreciation are applicable. The different rates are not due to "separable investments," because the investments in land and building are rarely if ever separable, but because separate rates are the proper and realistic method of measuring the deterioration of the whole. One might place an elevator, with a useful life of 20 years, in a building with a life of 50 years. To reflect income truly, the elevator must be depreciated over a life of 20 years, notwithstanding that it is inseparable from a building with a useful life of 50. It could be said that the building is deteriorating at a more rapid rate, as a percentage of cost, during the first 20 years than during the remaining 30. The result is the same. The separation of land and improvements, machinery and building, is an

expediency of accounting, which applies with equal force to a leasehold and fee simple. This Court so holds in *Helvering v. F. & R. Lazarus & Co.*, supra.

CONCLUSION.

Certiorari ought, for the foregoing reasons, be granted to remove from the law of taxation as it relates to a large segment of financial and business transactions the two gravest evils within judicial cognizance in taxation, namely, uncertainty and inequality. The law is uncertain in that final decisions conflict with each other, and Respondent has not found a consistent rule. It is inequal in that different results are achieved upon facts differing in only immaterial respects—whether the taxpayer's name be May or Century or a lease be for 30 years with option to renew or for 95 years with option to cancel, whether the condition be subsequent or precedent.

Adam Smith tries to weigh the relative evils. (*Wealth of Nations*, 257 [5th ed., 1789].)

> "The certainty of what each individual ought to pay is, in taxation, a matter of so great importance, that a very considerable degree of inequality, it appears, I believe, from the experience of all nations, is not near so great an evil as a very small degree of uncertainty."

In this case the two are related. The uncertainty in the law has resulted in inequality, for the Respondent is pressing his assertion of liability in this case, and omitting to press the same assertion against numerous others, as May Department Stores Company, whose case is officially reported, and the others mentioned in current publications quoted above. To the same extent the inequality has resulted in uncertainty, for no one can know for the future

whether he resembles more nearly May or Lazarus on the one hand or Century on the other.

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In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 548

CENTURY ELECTRIC COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 174–193) are reported at 15 T. C. 581. The opinion of the Court of Appeals (R. 211–220) is reported at 192 F. 2d 155.

JURISDICTION

The judgment of the Court of Appeals was entered on October 31, 1951. (R. 220–221.) The petition for a writ of certiorari was filed on January 22, 1952. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

QUESTIONS PRESENTED

1. Whether for tax purposes the transaction involved was a sale of the foundry property for $150,000 resulting in a deductible loss in 1943, as taxpayer contends, or, as the courts below held, an exchange of property held for productive use in a trade or business for $150,000 and property of a like kind to be held for productive use in a trade or business, as to which no loss is recognized under subsections (b) (1) and (e) of Section 112 of the Internal Revenue Code and Section 29.112 (b) (1)–1 of Treasury Regulations 111.

2. Whether, if the claimed loss is denied, a part of the claimed loss is deductible as depreciation over the remaining life of the improvements made on the foundry property prior to the exchange, as taxpayer contends, or, as the court below held, the whole is deductible over the 95-year term of the lease.

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and Treasury Regulations are set forth in the Appendix, *infra,* pp. 14–17.

STATEMENT

The findings of fact of the Tax Court, stated in great detail, are contained in the record at pages 174–186. The Court of Appeals, after stating that taxpayer accepts the Tax Court's find-

ings of fact as correct (R. 212), summarized the facts as follows (R. 212–216):

Since its organization in 1901 petitioner, hereinafter called the "taxpayer", has been continuously successful in business. In its income tax return for the year 1943 it reported gross sales of $17,004,839.73 and gross profits from sales of $5,944,386.93. On December 31, 1942, taxpayer owned land, buildings, and improvements of the total depreciated cost of $1,902,552.16. On December 31, 1943, its actual cash on hand amounted to $203,123.70. During the year 1943 it distributed cash dividends of $226,705.69 and made a contribution to Washington University of $42,500. It also held tax anticipation notes and Series G bonds totaling $2,000,000, readily convertible into cash and sufficient to liquidate its outstanding 1943 tax liability and its two outstanding 90-day bank notes due January 20, 1944. (R. 212–213.)

Taxpayer has always operated its business in large part on borrowed capital. In 1943 it had open lines of credit with the Chase National Bank of New York of $300,000, with the Boatmen's National Bank of St. Louis of the same amount, and with the Mercantile-Commerce Bank and Trust Company of $400,000. At the end of 1943 its outstanding loans from the Mercantile bank amounted to $600,000 approved by the authorized officers of the bank. Taxpayer has always been

able to liquidate its outstanding 90-day bank loans as they became due either by payment or renewal. (R. 213.)

The 1943 assessed value of taxpayer's foundry building and the land upon which it is located was $205,780. There was evidence that in St. Louis real property is assessed at its actual value. There was also evidence introduced by taxpayer before the Tax Court that the market value for unconditional sale of the foundry building, land, and appurtenances was not in excess of $250,000. (R. 213.)

As of December 1, 1943, the adjusted cost basis for the foundry building, land, and appurtenances was $531,710.97. The building was a specially designed foundry situated in a highly desirable industrial location. It is undisputed that the foundry property is necessary to the operation of taxpayer's profitable business and that taxpayer never at any time considered a sale of the foundry property on terms which would deprive taxpayer of its use in its business. (R. 213.)

Taxpayer's explanation of the transaction involved here is that in the Spring of 1943 a vice-president of the Mercantile bank where taxpayer deposited its money and transacted most of its banking business suggested to taxpayer the advisability of selling some of its real estate holdings for the purpose of improving the ratio of

its current assets to current liabilities by the receipt of cash on the sale and the possible realization of a loss deductible for tax purposes. Taxpayer's operating business was to be protected by an immediate long-term lease of the real property sold. (R. 214.)

Taxpayer's board of directors rejected this proposition as unsound. But in July, 1943, when a vice-president of the Mercantile bank suggested to taxpayer's treasurer that it would be a good idea for taxpayer to pay off all its bank loans merely to show that it was able to do so, taxpayer interpreted this advice as a call of its bank loans. Acting on this interpretation, taxpayer borrowed from the First National Bank in St. Louis on the security of tax anticipation notes held by it funds with which it discharged all its bank loans. Immediately thereafter it reestablished its lines of bank credit and began consideration of a sale of the foundry property and contemporaneous lease from the purchaser. (R. 214.)

On September 2, 1943, taxpayer's board of directors adopted a resolution that the executive committee of the board study the situation "and present, if possible, a plan covering the sale and rental back by Century Electric Company of the foundry property". The decision to enter into the transaction described was communicated to the Mercantile bank, but taxpayer never publicly offered or advertised its foundry property for

sale. The Tax Court found that taxpayer "was concerned with getting a friendly landlord to lease the property back to it, as there was never any intention on the part of petitioner to discontinue its foundry operations". Several offers to purchase the foundry property at prices ranging from $110,000 to $150,000 were received and rejected by taxpayer. (R. 214–215.)

At a special meeting of the board of directors of taxpayer on December 9, 1943, the president of taxpayer reported that the officers of taxpayer had entered into negotiations for the sale of the foundry property to William Jewell College for the price of $150,000 with the agreement of the college "that in addition thereto said Trustees of William Jewell College further have agreed to execute a lease of the property so purchased to Century Electric Company for the same time and on substantially the same terms and conditions which were authorized to be accepted by the special meeting of shareholders of this corporation, held on the 24th day of November, 1943". The stockholders at the November meeting had authorized the sale of the foundry property at not less than $150,000 cash, conditioned upon the purchaser's executing its lease of the property sold for a term of not less than 25 and not more than 95 years. The board by resolution approved the proposed transaction with William Jewell College, but on condition that "this corporation will acquire from Trustees of

William Jewell College, a Missouri Corporation, an Indenture of Lease * * * for a term of not less than twenty-five years and for not more than ninety-five years". The resolution set out in detail the terms of the lease from the college to taxpayer, which was for a period of 95 years, approved the form of the deed from taxpayer to the college, authorized the president and secretary of taxpayer to execute the lease after its execution by the trustees of the college, and directed "that the president and secretary of this corporation be authorized to deliver said Warranty Deed to said purchaser upon receiving from said purchaser $150,000 in cash, and upon receiving from said purchaser duplicate executed Indenture of Lease on the forms exhibited to this Board". The resolution provided that the deed and lease should be dated December 1, 1943, and effective as of that date. (R. 215–216.)

The deed and the lease were executed and delivered as provided by the resolution of taxpayer's board of directors. Neither instrument referred to the other. The deed was in form a general warranty deed, reciting only the consideration of $150,000 in cash. The lease recited among others the respective covenants of the parties as to its term, its termination, and as to the rents reserved. (R. 216.)

As of December 31, 1942, the ratio of taxpayer's current assets to its current liabilities

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was 1.74. The $150,000 in cash received by taxpayer on the transaction increased the ratio of current assets to current liabilities from 1.74 to 1.80. The loss deduction which taxpayer claims on the transaction and its consequent tax savings would if allowed have increased the ratio approximately twice as much as the receipt of the $150,000. (R. 216.)

The Tax Court rejected taxpayer's contention that it is entitled to a loss deduction in the amount of $381,710.97 (the difference between $531,710.97, the adjusted cost basis of the foundry property, and $150,000), holding that the foundry property transaction was an exchange of property for property of like kind and $150,000 and, accordingly, a transaction under which no loss is recognized under subsections (b) (1) and (e) of Section 112 of the Internal Revenue Code and Section 29.112 (b) (1)–1 of Treasury Regulations 111. (R. 186–192.) The Tax Court also rejected taxpayer's alternative contention that it is entitled to deduct the amount of the claimed loss as depreciation over the remaining life of the improvements on the foundry, but held that taxpayer is entitled to depreciate the claimed loss over the 95-year term of the lease and is therefore entitled to a depreciation deduction for 1943 in the amount of $334.83. (R. 192–193.) The Court of Appeals affirmed the Tax Court on both issues. (R. 217–220.)

ARGUMENT

Merely to show, as taxpayer does, that sale and lease-back arrangements are becoming increasingly common (Pet. 9–20) does not suffice to demonstrate that the questions here raised are sufficiently important to warrant review at this time. Like other broad categories of business transactions—like sales generally, or leases, or mortgages—sales and lease-backs pose a wide variety of tax and other legal problems. The points of present significance are that, on the particular questions raised by this particular case, and by no means involved in all sale and lease-back arrangements, the concurrent decisions of the two courts below are correct and there is no conflict. We submit, therefore, that review by this Court is unwarranted.

1. On the first issue, the court below properly held that the sale and lease-back constituted an exchange of property held for productive use in trade or business (the foundry property) for property of like kind to be held for productive use in trade or business (the same property, held under a 95-year lease) and $150,000, and that, accordingly, no loss in respect of the transaction is recognizable under subsections (b) (1) and (e) of Section 112, Internal Revenue Code (Appendix, *infra,* pp. 15–16). The sale and lease-back arrangement was intended to be (see pp. 5–7, *supra*), and was correctly considered as, a single,

integrated transaction (see R. 217–219), and thus an exchange. The conclusion that the exchange was for property of like kind is required by Section 29.112 (b) (1)–1 of Treasury Regulations 111 (Appendix, *infra*, p. 17), which provides that no gain or loss is recognized on an exchange of real estate for a leasehold of a fee with 30 years or more to run. This provision, contained in the Regulations since 1924, has, as the court below stated (R. 219), survived successive reenactments of the Internal Revenue Acts and has therefore acquired the force of law. *Commissioner* v. *Crichton*, 122 F. 2d 181 (C. A. 5).

Taxpayer's assertion (Pet. 5–6, 22) of a "conflict" between the Tax Court's ruling in *May Department Stores Co.* v. *Commissioner*, 16 T. C. 547, and the decision below (which affirms the Tax Court) rests upon nothing more than a crucial error in reading the facts of the former case. Contrary to taxpayer's statement (Br. 22), the lease involved in *May Department Stores* was for a term of 20 years, without renewal privileges. Accordingly, there was no question there, as there was here, whether the sale and lease-back arrangement constituted an exchange for property of like kind within the meaning of Section 112 (b) (1) and (e) of the Code, but the wholly different—and presently immaterial—question whether the transaction involved a bona fide sale.

Plainly irrelevant, Section 112 (b) (1) and (e) did not even merit discussion in the Tax Court's opinion.[1]

2. It is undisputed that, as a result of the exchange effective December 1, 1943, William Jewell College became the owner of the foundry property and taxpayer acquired a 95-year leasehold of that property plus $150,000. It is clear, therefore, that, having transferred its ownership of the property for the lease, taxpayer was not entitled to deduct its investment on the basis of the estimated rate of depreciation of the improvements on the property. *Weiss* v. *Wiener*, 279 U. S. 333. As the court below held (R. 220), the taxpayer's capital investment after the exchange was in the "leasehold and not its constituent properties," and was accordingly depreciable over the 95-year term of the lease.[2] See

[1] Cited by taxpayer (Pet. 5), but with no suggestion that they "conflict" with the decision below, *Standard Envelope Mfg. Co.* v. *Commissioner*, 15 T. C. 41 and *Brost Motors, Inc.* v. *Commissioner*, decided October 29, 1948 (1948 T. C. P-H Memorandum Decisions, par. 48,226), dealt with the same problem as *May Department Stores* v. *Commissioner*, *supra*. The lease involved in *Standard Envelope Mfg. Co.* was for a term of 24 years, without purchase or renewal option. The term of the lease in *Brost Motors, Inc.* is not mentioned in the Tax Court's memorandum decision and there is no suggestion there of the instant question under Section 112 (b) (1) and (e) of the Code.

[2] Before the Tax Court, taxpayer contended that its entire investment should be depreciable over the approximately 27

Southwestern Hotel Co. v. *United States*, 115 F. 2d 686, 688 (C. A. 5), certiorari denied, 312 U. S. 703.

Taxpayer errs in its assertion (Pet. 6) that this conclusion conflicts with the decisions in *Helvering* v. *Lazarus & Co.*, 308 U. S. 252, and *Duffy* v. *Central R. R.*, 268 U. S. 55. *Helvering* v. *Lazarus & Co.* held that where a transaction took the form of a transfer of ownership and lease-back of buildings but was in actuality a transfer of the buildings as security for a loan, the taxpayer, retaining his ownership, had a depreciable capital investment in the buildings. In the present case, the transfer of ownership was real and taxpayer became, after the exchange, a lessee. *Duffy* v. *Central R. R.* involved depreciation on improvements made by a lessee *after* possession as lessee, whereas taxpayer here claims entitlement to depreciation for improvements it made to the foundry property prior to its transfer of ownership of that property and its acquisition of the lease.

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remaining years of useful life of the foundry building (R. 8–9) rather than the 95-year period of the lease. On petition for rehearing by the Tax Court (R. 193–194), which was denied without opinion (R. 198), and in the court below, taxpayer altered this position to contend, as it does now, that the amount of the investment should be apportioned between the land and improvements and depreciated at the different rates applicable to these constitutent properties. The court below pointed out (R. 220) that this position "involves assumptions and inferences which find no support in the record."

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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FEBRUARY 1952.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

(l) [as amended by Sec. 121 (c) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

* * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money)received.

(c) *Recognition of Gain or Loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this chapter, shall be determined under the provisions of section 112.

* * * * *

(26 U. S. C. 1946 ed., Sec. 111.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

(1) *Property held for productive use or investment.*—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust

or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

* * * * * *

(e) [as amended by Sec. 121 (d) (3) of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Loss from Exchanges Not Solely in Kind.*—If an exchange would be within the provisions of subsection (b) (1) to (5), inclusive, or (10), or within the provisions of subsection (l), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

* * * * * *

(26 U. S. C. 1946 ed., Sec. 112.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * * *

(6) *Tax-free exchanges generally.*—If the property was acquired, after February 28, 1913, upon an exchange described in section 112 (b) to (e), inclusive, the basis * * * shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the

law applicable to the year in which the exchange was made. * * *

* * * * *

(26 U. S. C. 1946 ed., Sec. 113.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.112 (b) (1)–1. *Property Held for Productive Use in Trade or Business or for Investment.*—As used in section 112 (b) (1), the words "like kind" have reference to the nature or character of the property and not to its grade or quality. One kind or class of property may not, under such section, be exchanged for property of a different kind or class. The fact that any real estate involved is improved or unimproved is not material, for such fact relates only to the grade or quality of the property and not to its kind or class. * * *

No gain or loss is recognized if (1) a taxpayer exchanges property held for productive use in his trade or business, together with cash, for other property of like kind for the same use, such as a truck for a new truck or a passenger automobile for a new passenger automobile to be used for a like purpose, or (2) a taxpayer who is not a dealer in real estate exchanges city real estate for a ranch or farm, or a leasehold of a fee with 30 years or more to run for real estate, or improved real estate for unimproved real estate, or (3) a taxpayer exchanges investment property and cash for investment property of a like kind.

* * * * *

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1951.

CENTURY ELECTRIC CO.,
Petitioner,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 548.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit.

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Statutes Cited.

Internal Revenue Code:

Sec. 112 (b) (1)..... 5, 6

Sec. 117 (h)..... 5

Regulations 111, Sec. 29.112 (b)..... 5

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1951.

CENTURY ELECTRIC CO.,
Petitioner,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.
No. 548.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit.

BRIEF

For Petitioner in Reply to Brief for the Respondent in Opposition.

STATEMENT.

This brief is in reply to respondent's brief in opposition to the granting of petition for certiorari in the above-entitled case.

ARGUMENT.

1. Respondent's primary position, stated at the opening of his Argument, is that it is immaterial that this case involves, as it does, questions and arrangements which are common and therefore of frequent occurrence in the administration of the revenue laws and of weight in the determination of the amount of taxes due, as well as in the arrangements of taxpayer affairs. He says that is not important. It would be an act of supererogation to cite cases in which certiorari was granted where the importance of the case was the effect upon the revenues or on the day-to-day transaction of business. We think these things are important.

Then, says respondent, "The points of present significance are that, on the particular questions * * * the concurrent decisions of the two courts below are correct." If it be the rule that no decision should be reviewed on writ of certiorari if it is correct, then every case should be decided on the petition for that writ, and the granting of the writ would be a reversal of the decision below. Obviously, the issue presented on this petition is not the correctness or uncorrectness of the decisions below. That the result is questionable is amply demonstrated by the decision of the Tax Court of the United States in *May Department Stores Company v. Commissioner*, 16 T. C. 547, and the unreal distinction respondent draws between that case and this.

That there is no conflict between decisions of courts of appeal is not a reason for denying the writ; if there were such a conflict, that would not be the only reason for granting certiorari.

Thus the issues on this petition are pointed in the first paragraph of respondent's Argument:

(a) Will certiorari be granted in any case not in conflict with another Court of Appeals case? This Court's

rules answer the question in the affirmative, and indeed, in individual justice, **anticipating** a conflict and preventing it, are more important than resolving it after it has arisen. The first decision is more likely to be wrong than the second and after a conflict arises, the parties to the first case will be forever barred from redress and justice. Of course, it is more difficult to prevent a conflict than to resolve one; if one is prevented, it will never be known with certainty that one would otherwise have arisen.

(b) Is it important that the transactions here presented "pose a wide variety of tax and other legal problems," the resolution of which seriously affects both federal revenues and arrangements which "are becoming increasingly common" in the daily financial transactions of citizens? Admittedly, there are many questions which are **not** presented in this case. No case will ever arise presenting **at once** all the questions of sale and lease-back—from the tax effect of entering into the arrangement, through the years of the lease, to the tax effects of the termination by lapse of time, by mutual agreement, and by forfeiture. This case presents the questions of the transaction—sale and lease-back—and of depreciation. Not much more can arise in one case. Whether rentals are deductible; whether gain or loss is recognized when the lease ends; and other questions may arise in other cases. These questions may become important. To the present, they are academic.

2. Respondent's Argument that the transaction in this case constitutes an "exchange" raises a question which goes to the merits. The mere statement that petitioner "exchanged" property for **cash** poses the important problem. There cannot be an "exchange" of property for cash, for such a transaction is by definition a "sale".

To be sure, the statement demonstrates the futility of respondent's attempted reconciliation of the decision of the Court below with that of the Tax Court in *May Department Stores Co. v. Commissioner*, 16 T. C. 547. In

that case property was "exchanged" for cash and a 20-year lease, with **power** of renewal, although no right of renewal was expressed in the lease. This was held to be a "sale". In the instant case, it was held to be an "exchange".

That the lease is for less than 30 years may well be relevant in determining whether it is "property of like kind" with a fee. But to assert that the difference between a sale and an exchange is the difference between a 29-year and a 30-year lease is not sensible. The case respondent cites (*Commissioner v. Crichton,* 122 F. [2d] 181) makes no such distinction.

Thus, the *May* case holds that upon a sale and lease-back of property there was a sale, and not an exchange. The Court below has held that there was an exchange and not a sale. Respondent attempts to revise the holding in the *May* case, and to construe it to hold that there was an "exchange" of unlike properties, saying that here there was an exchange of **like** properties. The Tax Court expressly held, and stated, however, that the transaction was a sale. It conflicts with the holding of the Court below in this case, whether the lease to the May Company was for more or less than 30 years; whether it was or was not renewable. Respondent contended in that case that the lease was renewable; if it had been, the result would still have been the same.

The transaction in the *May* case was held to be bona fide. That in this case is admitted to be so (Brief for the Respondent in Opposition, p. 12). The transactions were alike in all respects material to the difference between "sale" and "exchange".

3. Respondent cites *Weiss v. Wiener,* 279 U. S. 333 and *Duffy v. Central R. R.,* 268 U. S. 55, as establishing that a lessee may depreciate improvements on a leasehold over the period of their useful life if the improvements were made after the lease, but only over the period of the lease

(or not at all?) if made prior to the lease. The distinction is without reason, and is not that made by this Court. The true distinction is real: if the lessee has an investment or cost in the improvements, he may depreciate them. If he has none, he may not. The pertinent inquiry is, who paid for the improvements—who actually suffers the loss by depreciation—not when were the improvements made. If petitioner acquired its leasehold in exchange for its fee, and if the leasehold is property of a like kind with the fee, so that no loss is recognized, as respondent asserts, then the investment in the leasehold is **like** that in the fee, for the investment is, so to speak, one of the twigs in the bundle which constitutes likeness.

Respondent carries his water in a leaky pail. He says that the leasehold is like the fee for purposes of section 112 (b) (1) of the Internal Revenue Code, so that the fee was "exchanged" for property "of a like kind." Now the pail is dry and he returns to fill it anew: The cash consideration was paid for the fee; the fee was "sold" or at least "exchanged" for property of **unlike kind** for purposes of section 23. Thus he contradicts his own regulations [Regulations 111, Sec. 29.112 (b), quoted in his Brief in Opposition, p. 17]. If the fee was exchanged for a leasehold, then the acquisition of the leasehold dates back to the acquisition of the fee, one being merely substituted for the other, and the improvements were made subsequent to the acquisition. Section 117 (h) of the Internal Revenue Code so provides.

The difference between *Weiss v. Wiener* and *Duffy v. Central R. R. Co.* is easily demonstrated by simplifying the facts in each:

In *Weiss v. Weiner*: Lessee leases improved property paying a rental based on the value of land and improvements. Obviously, the rentals include depreciation, which the **lessor** deducts from the rents he receives.

In *Duffy v. Central R. R. Co.*: Lessee leases unimproved property paying a rental based on the value of the land alone, and then builds improvements. Obviously, the rentals do not include depreciation, and the lessor deducts none, but the lessee does.

Here, upon respondent's assertion, petitioner owned property and made improvements; then "exchanged" the improved property for other, but like, improved property. If there was an exchange, then obviously petitioner has an investment in the improvements received in exchange, just as it had an investment in the improvements given in exchange, and the rentals do not include depreciation. To argue the contrary is to deny an exchange—as petitioners do—asserting that the rentals are fair, and thus the leasehold is nothing of value, from which it follows that the cash was the whole consideration for the fee and there was a sale, not an exchange at all.

A simple, clear case of exchange will serve to illustrate: A taxpayer leases an unimproved lot and builds a building on it. He deducts depreciation for a few years, based on the life of the building. He then exchanges his leasehold for an identical leasehold, with like improvements. Obviously, he may still deduct depreciation of the improvements. The only confusing factor in the case at hand is that to raise the question of depreciation it is necessary to assume that there was an exchange, when, in fact, there was none.

Helvering v. Lazarus & Co., 308 U. S. 252, refutes respondent's distinction. It is perfectly true that in that case the sale and lease-back were held to be in substance a mortgage, the significance of which holding is that the taxpayer continued to own the property. Here, if it be held that petitioner "exchanged" the fee for the leasehold within the provisions of section 112 (b), I. R. C., the holding will have the same significance—that petitioner continued to own the same property. True, petitioner's title

was different—lessee rather than freeholder—and so was Lazarus' title.

It is therefore submitted that it is abundantly clear, without significant contradiction, that

(a) The questions presented in this case are important to the daily financial life of businessmen and the transaction of their affairs.

(b) This case poses questions which are not authoritatively answered and are doubtful in the present state of decisions and statutes.

(c) One of the questions presented is answered by the Court below in a manner inconsistent with the applicable decisions of this Court.

Hence it follows that the questions should be considered by this Court. Whether the decision of the Court below should be affirmed, reversed or modified is not properly considered here, for no such action should be taken without the consideration which is given **after** the writ of certiorari is granted.

Respectfully submitted,

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